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MFDA Bulletin

Member Information

For Distribution to Relevant Parties within your Firm

2020 Compliance and Member Education Priorities

This bulletin summarizes key regulatory initiatives of the MFDA's Compliance and Member Education Departments for 2020. A key part of our regulatory approach, and the initiatives and priorities outlined below, is a focus on preventing compliance issues through proactive steps and guidance.

MFDA Compliance and Member Education staff are pleased to assist Members and provide guidance prior to implementing business changes. In particular, we are supportive of initiatives that increase the efficiency and effectiveness of supervision such as the automation of supervisory activities and initiatives that enhance investor choice such as the offering of exchange-traded funds. We strongly encourage Members to contact us to discuss their plans where they are contemplating such business changes. To further support Members, supervisory staff and Approved Persons in preventing compliance issues, MFDA Member Education staff are also available to present at Member and industry events to increase understanding of current MFDA regulatory requirements and initiatives.

Member Outreach Initiative

This year we will continue to implement the actions described in [MFDA Bulletin #0792-M MFDA Member Outreach Initiative](#). These actions include 1) supporting the Rule Review Project; 2) continuing to take steps to enhance the transparency of the MFDA's compliance approach; and 3) supporting Members in their Compliance efforts through guidance and collaboration.

1. COMPLIANCE

We issue our compliance priorities annually to provide transparency and to support Members in their own efforts to identify potential risk areas and enhance their supervision and controls. The initiatives and priorities reflect the continuing evolution of our compliance program and our commitment to an approach that improves client outcomes and is proactive, collaborative and risk-based.

The use of data, analytics and technology in our compliance program has increased significantly in recent years and is key to our compliance approach as we move forward. Through various initiatives including the two MFDA Client Research Projects we have obtained invaluable data on Member activities, client investments and investor outcomes. This data-driven, analytical approach to compliance allows us to focus on the issues that are most impactful to clients and is integral to our approach to many of the topics highlighted below.

Highlights

Performance Reporting

In 2019, we received information as part of our Client Research Project, which included, for the first time, information on individual client account performance for all clients of MFDA Members. We are reviewing the performance data to gain further insight into client outcomes and to identify instances where performance may have been inaccurately reported. Members should carefully review and test their performance reporting, as inaccurate reporting can significantly impact investment decisions. Where unexpected or unusual returns are identified it is important for Members to investigate such instances to identify the specific cause and determine the extent of any issue.

Suitability

Suitability remains the primary area of focus in our examinations. In particular, we will continue to focus our testing on seniors, vulnerable clients and other clients who may be at greater risk for suitability issues including clients with limited income or financial assets and clients with limited investment knowledge. Please also see the comments below under Approved Person Targeted Review Follow-Up.

Approved Person Targeted Review Follow-up

In 2019, we issued a report on our [Approved Person targeted review \(Bulletin #0783-C\)](#). The report included a summary of key findings, recommendations and best practices. The findings identified in the targeted review of high risk Approved Persons included 1) concentration in high risk sector funds; 2) uniformity of KYC information; and 3) investment patterns where all clients were 100% invested in equity funds.

In this cycle of examinations, we will be reviewing what steps Members have taken to respond to these findings and to implement supervisory procedures to detect such issues with their Approved Persons.

Procedures for Determining Client Risk Tolerance

In past communications ([Bulletin #0611-C: MFDA Discussion Paper on the Use of Investor Questionnaires](#)), we have highlighted the importance of accurately assessing a client's risk tolerance or risk profile and maintaining sufficient documentation supporting how the KYC elements were determined. Many Members have implemented investor questionnaires or similar tools to help with this process. Alternatively, detailed notes can also support how risk tolerance, time horizon and investment objectives were determined. We commonly ask to see this supporting documentation in examinations, particularly where we believe the supervisor should have questioned the reasonability of the documented KYC information or where we observe a pattern of similar KYC information for all of an Approved Person's clients (uniformity of KYC information).

Conflicts of Interest and Compensation – Referral Arrangements

Conflicts of interest continue to be a top priority in our compliance program. In recent years, we have specifically reviewed topics such as compensation and incentive practices as well as Member procedures regarding promotional activities.

In 2019, we collected further data on Member referral arrangements. We have previously highlighted the compensation associated with some referral arrangements and the potential conflicts of interest that can exist ([Bulletin #0705-C: Review of Compensation, Incentives and Conflicts of Interest](#)). We continue to be concerned with referral arrangements with portfolio managers where the referral fee amounts to a significant portion of the total management fee paid by the client. In one instance, the referral fee was 60% of the total management fee and in another case was 100% of the management fee in the first year. The data also shows that some Members have numerous referral arrangements in place. Therefore, we remind Members of the importance of conducting adequate due diligence prior to entering into any referral arrangement and ensuring conflicts of interest are adequately addressed.

Branch Reviews

Our Members operate in over 20,000 locations across Canada. Given our Members' extensive network of operations, MFDA Policy No. 5 branch reviews are a critical component of an effective supervision structure and an area of focus in our examinations. Particular areas where we have previously identified weaknesses that we will be following-up on this cycle of examinations include:

1. The Member's risk rating methodology and in particular the Member's procedures for identifying high risk branches;
2. The scheduling of branch examinations, including procedures to ensure newly registered locations are reviewed in a timely manner; and
3. The reporting and resolution of branch review findings.

To assist Members in establishing an effective branch review program, we have posted a workshop and related tools and templates on our Members-Only site. Should any Member require additional or more tailored assistance, they should contact their Compliance Manager.

Account Transfers

Transfer delays can have a significant impact on clients. Some Members have advised that they have experienced delays in the account transfer process when dealing with entities who are not MFDA Members. We recognize that the transfer process can be complicated given the types of assets involved, the various financial intermediaries that may hold assets and the different ways assets are held. While we understand delays may be unavoidable in certain circumstances, there should not be unnecessary systemic obstacles that create delays in the client's ability to transfer their assets in a timely manner. Accordingly, we will be engaging in a consultation with industry stakeholders to better understand their views, experiences and recommendations to improve the transfer process and achieve better outcomes for clients.

Exchange Traded Funds

In the past few years, the number of Members offering ETFs has been increasing. We are supportive of Members offering ETFs and have assisted several of our Members in successfully implementing an ETF platform. To further help Members, we have issued compliance guidance that can be found on our Members-Only site, outlining some of the issues to consider when offering ETFs. We also continue to encourage Members to speak to us and collaborate when offering new products, services or technology. Proactive collaboration can lead to more successful implementation of operational change by Members and greater awareness of Member activities by MFDA staff. We invite Members to contact their Compliance Manager if they would like to offer ETFs or implement other operational changes.

Policy Development

Compliance staff participated on the Canadian Securities Administrators Client Focused Reforms (CFR) Working Group to provide input regarding Member operations and practical compliance considerations in applying aspects of the CFRs. This year we will assist our Policy department in developing MFDA's CFR conforming Rule amendments and related guidance. We will also be amending our examination program to reflect the CFR amendments.

2. MEMBER EDUCATION

Over the past year the Member Education Department presented at Member and industry events on various topics including regulatory initiatives, seniors' issues, supervisory requirements, branch review programs, KYC practices, suitability, referral arrangements, outside activities, and cybersecurity. MFDA supports Members in their education and training activities because a greater understanding of regulatory requirements leads to better and more compliant outcomes. If a Member would like MFDA staff to participate in its training and education events, they should contact the Member Education department.

The Member Education Department also participates in initiatives designed to further industry education and enhance investor protection. Key initiatives for 2020 are outlined below.

Highlights

Continuing Education (CE) Requirements

In September, 2019, MFDA received approval or non-objection from the Canadian Securities Administrators to proposed requirements under MFDA Rule 1.2, Rule 1.2.6 and Policy 9 which establish the MFDA's CE framework ([Bulletin #0793-P](#)). Before the CE requirements can come into effect, the accreditation standards need to be finalized and development of the CE reporting and tracking system (CERTS) needs to be completed.

In July 2019, we issued a discussion paper requesting stakeholder input regarding an appropriate accreditation process. Based on that feedback, we will be issuing proposed accreditation standards for comment early this year. CERTS system development should also be completed early this year. Once CERTS is developed, we will be providing training and education for all system users.

Cybersecurity

In 2017, MFDA retained a consultant to perform a survey of all Members' cybersecurity frameworks and issue individualized reports of the results. Building on that approach, in 2018 we retained a consultant to perform voluntary interactive assessments of the cybersecurity capabilities and readiness of Members to support and improve their practices ([Bulletin #0763-C: Cybersecurity Assessment Program](#)). Rather than performing table top testing or hypothetical simulations, we believed it would be more effective if the consultant undertook testing of the Members' actual systems and controls by performing penetration testing and vulnerability scans. All Members who have undertaken the project provided positive feedback and felt it was a valuable experience and appreciated the MFDA's support. Given this feedback we have extended this program and continue to encourage firms to participate. In 2020, we will be issuing another cybersecurity survey to better understand the current status of Member practices and issuing further guidance.

Total Cost Reporting

MFDA is supportive of clients having relevant information relating to the costs associated with investing so that they can make informed investment decisions. MFDA Members provide services to over half of Canadian households and mutual funds comprise the vast majority of assets held by Member clients. Given these facts, the MFDA has published a number of discussion papers in order to understand the implications of expanding current cost reporting to include additional cost information such as ongoing mutual fund management fees and operating costs. This year, we will continue to explore total cost reporting alternatives and collaborate with other regulators.

Client Research

Regulators are increasingly using data to drive regulatory activity. Given technological advances within the industry, the MFDA identified the opportunity to obtain detailed but anonymous information relating our Members' clients and their business. This unprecedented view into retail clients has been invaluable in performing our regulatory activities. We use the information to focus on higher risk activities and vulnerable clients in our examinations (see Approved Person Targeted Review above) and to assess the impact of regulatory policy. We also publish a report

summarizing the data to the public to promote knowledge and understanding of the important role our Members have in the wealth management industry. In 2019, we issued our second client research request collaboratively with the Autorité des marchés financiers. We expanded on the information requested to include cost and performance data. This new information will assist us in better understanding actual client outcomes. We will be publishing a report summarizing the results of the client data request this year.

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